



# The Highland Council Pension Fund

Interim Report

2015/16

Prepared for Members of the Highland Council as  
Administering Authority for the Highland Council  
Pension Fund

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Stephen Boyle is the engagement lead for the audit of The Highland Council Pension Fund for the period 2012/13 to 2015/16.

This report has been prepared for the use of The Highland Council Pension Fund and no responsibility to any member or officer in their individual capacity or any third party is accepted.

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# Introduction

1. This report summarises the findings from the interim audit work carried out as part of the 2015/16 audit of the Highland Council Pension Fund. The nature and scope of the audit were outlined in our Annual Audit Plan presented to the Pensions Committee on 18 February 2016 and follows the requirements of Audit Scotland's Code of Audit Practice which was published in May 2011.
2. Our work covered the following areas:
  - the operation of the internal controls in key financial systems
  - review of the fund's governance arrangements.
4. Our report has been prepared on an exception basis and highlights only those areas where we identified control weaknesses or where procedures could be further improved. The issues reported are those which have come to our attention during the course of our normal work and are not necessarily, therefore, all the risk areas that may exist.
5. It remains the responsibility of management to determine the extent of the internal control system appropriate to the fund. We would stress, however, that an effective system of internal control is an essential part of the efficient management of any organisation.

## Management action

6. Appendix A is an action plan setting out our recommendations to address the risks we have identified during the course of our audit. Officers have considered the issues and agreed to take the specific steps in the column headed 'Management response and action'.
7. Members and the Executive Leadership Team should ensure that they are satisfied with the proposed action and have a mechanism in place to assess progress and monitor outcomes.

## Acknowledgement

8. The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.

# Internal Control

9. Audit Scotland's Code of Audit Practice requires us to assess the systems of internal control put in place by management. In carrying out this work, we seek to gain assurance that the fund:
  - has systems for recording and processing transactions which provide a sound basis for the preparation of the financial statements and the effective management of its assets and interests
  - has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
  - complies with established policies, procedures, laws and regulations.
10. In accordance with ISA 330, paragraphs 14 and 15, our audit judgements are based on current year testing of controls and, where appropriate, prior year results. Where controls have not been tested or where control weaknesses are identified by internal or external audit testing, auditing standards require us to consider the impact of these weaknesses on our planned approach to the audit of the financial statements, and to amend it as necessary in order to obtain sufficient evidence that they are free of material misstatement.
11. We reviewed the following control systems in order to assess the extent to which we could gain assurances for the audit of the 2015/16 financial statements:
  - pension investments
  - pensions payroll and administration (excluding contributions).
12. Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible, and planned to take formal reliance from internal audit's work on pensions contributions in 2015/16. In addition, internal audit staff are also undertaking work to support the Audit and Risk Manager's opinion on the adequacy and effectiveness of the fund's key financial systems and governance arrangements.
13. At the time of writing this report, internal audit have yet to complete their work in these areas and so we will report our findings from our review of this work and any impact that it had on our approach to the audit of the financial statements in our annual audit report.
14. The fund also uses the main financial systems (payroll, accounts payable, accounts receivable, treasury management, cash & cash equivalents, and general ledger) of its administering authority, The Highland Council. We reviewed the key controls in operation within these systems as part of our audit of the council.

15. The council implemented a new financial management system with effect from 1 April 2015. This system is fundamental to the preparation of the fund's financial statements and our audit opinion, and so we have included our assessment of the operation of the key controls in operation within this system at paragraph 17 below.

## Audit findings

### Overall assessment

16. Our overall assessment is that the Highland Council Pension Fund has a satisfactory level of control in place within its pension investments and pension administration systems. We identified one area where the council could further improve its system of internal control and this is set out at paragraph 22 below.
17. There were, however, significant weaknesses within the controls in operation within the general ledger and accounts payable modules of the new financial management system during 2015/16 and so we were unable to take our planned controls assurance from these systems. These weaknesses have been reported in the Highland Council's *Interim Audit* report and an action plan agreed with management. A copy of this action plan is included as Appendix B to this report.
18. Paragraphs 19 to 21 set out weaknesses identified in the fund's reconciliation processes during 2015/16, together with the impact on our approach to the audit of the financial statements.

### Reconciliations

19. Since the introduction of the new financial management system, all income received by the pension fund and the council is processed through the new cash management system. During 2015/16, the cash management system posted all income, including pension fund income, to one bank account code (the AXIS income bank account) within the council's general ledger. As a result, the pension fund's bank balances were recorded in the council's general ledger throughout 2015/16. In order to ensure that income was recorded in the correct ledger code, transfers had to be made by journal entry once the council and pension fund bank account reconciliations had been brought up to date. This process was very resource intensive and could have been avoided if the cash management system had been set up to post income received to the correct bank account in the general ledger from the outset. Management has advised that, with effect from 1 April 2016, the cash management system is able to post income transactions directly to the correct bank accounts codes in the general ledger.
20. Reconciliations to bank statements provide valuable third party evidence that transactions are correctly recorded in the general ledger. The fund's income bank account reconciliation was not completed timeously during 2015/16. Work to identify the income incorrectly posted to the council's AXIS income bank account (see paragraph 19) and process correcting journal entries commenced in January 2016 but was not completed until May 2016 as part of the preparation of the final accounts. We will review the year end income bank reconciliation as part of our final accounts audit and,

dependent on our findings, amend our audit approach as appropriate.

**Refer Action Plan No. 1**

21. In previous years we have reported our concerns regarding the operation and reconciliation of the intercompany accounts used to manage transactions between the council and the pension fund. Our review of the February 2016 reconciliation noted an unexplained difference of £0.836 million which Finance staff believe may be due to issues connected with the operation of the cash management system noted at paragraph 19 above. We will review the year end intercompany accounts reconciliation as part of our final accounts audit and, dependent on our findings, amend our audit approach as appropriate.

**Refer Action Plan No. 2**

22. The Highland Council Pension Fund has six investment managers. After the end of each month, reconciliations are performed between the records of the global custodian (Northern Trust) and data provided by the investment manager. Our review of the market value reconciliation noted that this reconciliation is not consistently evidenced as reviewed by a senior officer.

**Refer Action Plan No. 3**

# Governance arrangements

## Audit findings

23. The Highland Council Pension Fund is administered by The Highland Council with management and decision-making responsibility delegated to the council's Pensions Committee. As part of the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:

- corporate governance and systems of internal control
- the prevention and detection of fraud and irregularity
- standards of conduct and arrangements for the prevention and detection of corruption.

24. In this part of the report we set out our findings from our review of the council's governance arrangements.

### **Standing orders, scheme of delegation and financial regulations**

25. The fund has adopted the council's standing orders, scheme of delegation and financial regulations to support the administration of its financial affairs. Our review of the council's governance arrangements noted that:

- the council's standing orders and scheme of delegation have yet to be updated to include reference to the Pensions Board and its interaction with the Pensions Committee
- the council's financial regulations have yet to be updated to reflect the requirements of the Local Authority Accounts (Scotland) Regulations 2014. These Regulations introduced a number of key changes with regard to the processes for approval and publication of both the unaudited and audited financial statements.

These points have been included in the Highland Council's action plan and management have agreed to update these key governance documents (refer to Appendix B nos. 11 and 12).

# Appendix A: Pension Fund 2015/16 Action Plan

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
<b>Internal Controls</b>				
1	<p><b>Bank reconciliations</b></p> <p>Reconciliations to bank statements provide valuable third party evidence that transactions are correctly recorded in the general ledger. The fund's income bank account reconciliation was not completed timeously during 2015/16. Work to identify the income incorrectly posted to the council's AXIS income bank account (see paragraph 19) and process correcting journal entries commenced in January 2016 but was not completed until May 2016 as part of the preparation of the final accounts.</p> <p><b>Risk:</b> the bank reconciliation process does not provide assurance that all transactions are complete and accurately recorded in the financial ledger.</p> <p><b>Recommendation:</b> bank reconciliations should be completed at the end of each month and reconciling items promptly investigated and cleared.</p>	<p>The initial issue with the coding of the income to the pension fund income account was resolved during the year and monthly bank reconciliations are now produced.</p>	<p>Finance Manager- Corporate Budgeting, Treasury and Taxation</p>	<p>30/6/2016</p>



Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
2	<p><b>Intercompany accounts reconciliation</b></p> <p>In previous years we have reported our concerns regarding the operation and reconciliation of the intercompany accounts used to manage transactions between the council and the pension fund. Our review of the February 2016 reconciliation noted an unexplained difference of £0.836 million which Finance staff believe may be due to issues connected with the operation of the cash management system noted at paragraph 19 above.</p> <p><b>Risk:</b> transactions between the pension fund and the council are not correctly disclosed in their respective financial statements</p> <p><b>Recommendation:</b> unexplained differences identified by the intercompany accounts reconciliation process should be promptly investigated and correcting action taken to ensure that the correct amounts are disclosed in the pension fund and council's general ledgers.</p>	<p>Following the introduction of the new finance system the company balances are checked at least each month to ensure they remain in balance.</p> <p>The unexplained balance in this audit finding will be explained following work on debtors and creditors as part of finalising the revenue account at the year.</p> <p>In future years the intercompany account will be reconciled monthly.</p>	Finance Manager- Corporate Budgeting, Treasury and Taxation	30/9/2016

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
3	<p><b>Market value reconciliation</b></p> <p>The fund has six investment managers. After the end of each month, reconciliations are performed between the records of the global custodian (Northern Trust) and data provided by the investment manager. Our review of these market value reconciliations noted that they were not consistently evidenced as reviewed by a senior officer</p> <p><b>Risk:</b> unexplained differences are not be investigated and corrected timeously if the report is not reviewed by a senior member of staff</p> <p><b>Recommendation:</b> all reconciliations should be evidenced as reviewed by a senior officer.</p>	<p>Reconciliations are now reviewed by a senior officer and the review will be evidenced</p>	<p>Finance Manager- Corporate Budgeting, Treasury and Taxation</p>	<p>30/6/2016</p>

# Appendix B: Council 2015/16 Action Plan

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
<b>Internal Controls</b>				
1	<p><b>Journal entries</b></p> <p>Our review identified that Finance staff can post and authorise their own journal entries and that there is no independent review of journal entries after they have been processed. This lack of authorisation and review of journal entries increases the risk of error in the accounts. Last year we highlighted in our Annual Audit Report that errors in the processing some of the year end journals had resulted in significant misstatements in Services' income and expenditure within the unaudited Comprehensive Income and Expenditure Statement. As a result of these findings, we have amended our approach to the final accounts audit to increase our testing of journal entries.</p> <p><b>Risk:</b> the risk of error in the accounts is increased</p> <p><b>Recommendation:</b> a journal approval process should be introduced supplemented by an independent review of journal entries posted to unusual ledger codes or for unusual (including round sum) amounts.</p>	<p>The ability to process journal entries is predominately limited to staff within the Finance service who should have the appropriate skills and knowledge to correctly process journal entries.</p> <p>Should any entries be processed in error it is anticipated these would be picked up by budget holders when viewing their budget holder reports.</p> <p>A central review of all year-end journals of a material size will be undertaken as part of the year end process.</p>	Head of Corporate Finance	30/6/17

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
2	<p><b>Reconciliations</b></p> <p>Control account reconciliations provide assurance that transactions and balances are correctly recorded in the general ledger. Our testing noted that the council's sales and purchase ledger control account reconciliations were not completed timeously during 2015/16 and were not up to date at the time of our audit (January 2016).</p> <p><b>Risk:</b> the reconciliation process does not provide assurance that all transactions are complete and accurately recorded in the financial ledger</p> <p><b>Recommendation:</b> control account reconciliations should be completed at the end of each month and reconciling items promptly investigated and cleared.</p>	<p>Due to the introduction of the new finance system, there were delays in the completion of some processes as new ways of working were being established.</p> <p>All reconciliations were completed by the year end.</p> <p>Sales and purchase ledgers are reconciled to control reports daily.</p>	Head of Corporate Finance	30/09/16

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
3	<p><b>Suspense accounts</b></p> <p>A suspense account is an account in the general ledger in which amounts are temporarily recorded when the proper account could not be determined at the time that the transaction was recorded. When the proper account is determined, the amount should be moved from the suspense account. Our testing noted that suspense account balances were not being promptly investigated and cleared during 2015/16.</p> <p><b>Risk:</b> transactions are not properly accounted for within the financial statements submitted for audit</p> <p><b>Recommendation:</b> suspense accounts should be regularly reviewed, investigated and cleared.</p>	<p>All suspense accounts were dealt with appropriately as part of the year end processes. Efforts will be made to keep the clearing of suspense accounts as up to date as possible but sometimes bank reconciliations will take priority.</p>	<p>Head of Corporate Finance</p>	<p>30/09/16</p>

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
4	<p><b>Budgetary control</b></p> <p>The budgetary control reports produced by the new financial management system allow budget holders to drill down and see which employees are being charged to their budget. Budget holders are not, however, asked to periodically confirm to the validity of the employees charged against their budget.</p> <p><b>Risk:</b> unauthorised employees are paid through the council's payrolls</p> <p><b>Recommendation:</b> budget holders should be asked to periodically confirm the validity of the employees charged against their budget.</p>	<p>The integration of payroll data into the budget holders reports is seen as an improvement as managers can now drill down from their summary report into specific transaction detail for all categories of expenditure.</p> <p>Finance staff who support budget holders will remind them to check the validity of their employee costs and the guidance note on budgetary control (part of the financial regulations) also alludes to the verification of costs charged.</p> <p>A short guidance note on 'what to do with the budget holders report' will be written and a link to the note will be provided as part of the monthly report that is sent to budget holders.</p>	Head of Corporate Finance	30/11/16

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
5	<p><b>Budgetary control</b></p> <p>The new financial management system introduced purchase order commitment accounting to the council for the first time. In February 2016, the Purchase Card Administrator wrote to all Integra users highlighting that <i>‘if order lines are not receipted and invoiced correctly by staff then this will lead to excessive charges in the ledger and an incorrect balance on the monthly budgetary control reports’</i>. The Purchase Card Administrator provided a list of outstanding purchase orders and asked all staff to review them and take corrective action, where necessary, in advance of the year end.</p> <p><b>Risks:</b> budgetary control reports are inaccurate which reduces the value of budget monitoring, and expenditure/creditors are overstated in the financial statements.</p> <p><b>Recommendations:</b> staff should be reminded of how to use the purchase order, goods receipting and commitment accounting functions within the purchase ledger. Periodic reviews should be undertaken to confirm that the system is being used correctly and that expenditure within the general ledger is valid and charged to the correct accounting period.</p>	<p>The introduction of commitment accounting in the new finance system is an improvement on the old system where the facility was not available.</p> <p>The guidance note referred to at finding 4 of this report will include reference to understanding commitment accounting. Periodic guidance is also issued by the procurement team.</p> <p>It is not considered a risk that expenditure or creditors would be overstated in the financial statements as a result of this as commitments would not be included in the annual expenditure as the goods or services will not have been received (if they would have been there would have been an actual expenditure transaction and not a commitment).</p>	Head of Corporate Finance	30/11/16

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
6	<p><b>Trial balance</b></p> <p>A trial balance report is produced daily to ensure that the general ledger system is in balance. The system records the user who generated the report but there is no evidence that the report has been reviewed by a more senior member of staff within the Finance Section, or what action has been taken when anomalies are identified.</p> <p><b>Risk:</b> anomalies in the daily trial balance report may not be investigated and corrected timeously if the report is not reviewed by a senior member of staff</p> <p><b>Recommendation:</b> the review of the daily trial balance report by a senior officer should be evidenced and the action taken to investigate and resolve anomalies recorded.</p>	<p>The staff member who does the daily reconciliation will investigate any anomalies and that is normally timeous. If action is not timeous the system will be imbalanced for a prolonged period.</p> <p>A senior member of staff is notified only on an exception basis if there are anomalies.</p> <p>Resolution of anomalies is likely to be done in conjunction with the finance system provider and a log of all calls to the provider is maintained.</p> <p>It is not considered necessary for a senior member of staff to review the daily trial balance report.</p>	N/A	N/A



Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
7	<p><b>Trial balance</b></p> <p>Audit testing identified that the trial balance report had not been in balance for most of 2015/16. Finance staff were aware of the issue which related to a negative entry being treated as a positive by the system but it was not corrected until February 2016. We are concerned that the system was able to change a negative entry to a positive entry without user intervention which resulted in a single sided entry being posted to the general ledger. Systems generally have inbuilt controls that do not allow single sided entries to be posted, and that require users to confirm the validity of postings that fall out with normal parameters.</p> <p><b>Risk:</b> the system cannot be relied on to accurately process entries input by users</p> <p><b>Recommendation:</b> an explanation should be requested from CAPITA as to why the system was able to change a negative entry to a positive entry without user intervention resulting in a single sided entry being posted to the general ledger. Assurance should be obtained that the system has been amended to prevent this happening in the future.</p>	<p>The system has controls to identify where errors may occur.</p> <p>This particular problem was in the way the interface with the AXIS system had been set up and on discovery of this issue a correction was immediately requested. Whilst the correction was awaited, the balance was consistently checked to ensure there was no movement in the position.</p> <p>The underlying cause of the error has been corrected by the supplier.</p> <p>We are confident that sufficient other controls are in place to be able to rely on the system.</p> <p>During the production of the accounts, all other transactions have been found to be in balance and this is further evidenced in the balanced year end trial balance.</p>	N/A	N/A

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
8	<p><b>Accounts payable</b></p> <p>Procedural guidance notes detailing how to process changes to supplier bank account details within the new financial management have yet to be updated although staff involved in the process have prepared basic notes for their own use.</p> <p><b>Risk:</b> requests to change suppliers' bank details may not be processed correctly in the absence of clear procedural guidance</p> <p><b>Recommendation:</b> procedural guidance notes should be updated so that staff are clear as to how to process a request for a change in a supplier's bank details.</p>	Guidance notes will be updated.	Head of Corporate Finance	30/10/16

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
9	<p><b>Accounts Payable</b></p> <p>The Integra Training Manual sets out how an invoice should be entered onto the purchase ledger system. The Manual recommends attaching a scanned copy of the invoice in the system so that it can be reviewed by the budget holder when authorising the transaction for payment, and be held in Integra in case of future queries. Our review of 30 invoices where no purchase order had been raised noted that this guidance was not being consistently followed. In 19 cases, the invoice had been signed as approved prior to being scanned on to the system. In 1 case, however, the invoice was not evidenced as approved for payment before being scanned, and in the remaining 10 cases no supporting documentation had been scanned onto the system.</p> <p><b>Risk:</b> payments made are not supported by an approved invoice or other supporting documentation</p> <p><b>Recommendation:</b> invoices or other supporting documentation should be signed / initialled as approved for payment and then scanned onto Integra in support of all payments made.</p>	<p>The ability to attach a scanned copy of an invoice into the finance system is a new development not present in the old finance system. At present it is only recommended that an invoice is attached due to the extra resource that would be needed to complete this task. As the Council moves towards electronic invoicing more invoices will be attached to transactions.</p> <p>All approvals are done on the Integra system so a signature on a physical invoice is not necessary.</p> <p>In line with the financial regulations and historic practice all invoices should be stored appropriately. Budget holders are responsible for ensuring the validity of any transaction prior to approving it.</p>	N/A	N/A

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
10	<p><b>System back ups and disaster recovery</b></p> <p>The council's new financial management system (Integra) is hosted by CAPITA. CAPITA have advised the council that system back ups are taken daily and stored off site and that a disaster recovery plan is in place and tested annually to ensure it remains fit for purpose. The council, however, has no evidence to support CAPITA's assurance that back ups are taken and stored off site nor that the CAPITA's disaster recovery plan is regularly tested.</p> <p><b>Risk:</b> the council may be unable to recover its financial management system in the event of a catastrophic failure</p> <p><b>Recommendation:</b> the council should ask CAPITA to evidence its system back up and disaster recovery arrangements.</p>	<p>The council will ask for evidence of the annual disaster recovery test completed by Capita as well as the system back up process.</p>	<p>Head of Corporate Finance</p>	<p>31/12/16</p>

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
<b>Governance</b>				
11	<p>The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 introduced the requirement for pension funds to set up a Pensions Board which would be responsible for assisting the administering authority in complying with scheme regulations and the requirements of the Pensions Regulator. The inaugural meeting of the Highland Council Pensions Board was held on 4 September 2015. The council's standing orders and scheme of delegation has yet to be updated to include reference to the Pensions Board and its interaction with the Pensions Committee.</p> <p><b>Risk:</b> standing orders and the scheme of delegation do not reflect the council's current structure.</p> <p><b>Recommendation:</b> standing orders and the scheme of delegation should be updated to include reference to the Pensions Board and its interaction with the Pensions Committee.</p>	The standing orders and scheme of delegation will be updated.	Head of Corporate Finance	31/12/16

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
12	<p>The Local Authority Accounts (Scotland) Regulations 2014 introduced a number of key changes with regard to the processes for approval and publication of both the unaudited and audited financial statements. The council's financial regulations have yet to be updated to reflect the requirements of the 2014 Accounting Regulations.</p> <p><b>Risk:</b> the council does not comply with the requirements set out in the 2014 Accounting Regulations.</p> <p><b>Recommendation:</b> financial regulations should be updated to reflect the requirements of the 2014 Accounting Regulations.</p>	<p>A report containing suggested revisions to Financial Regulations was considered by the Audit &amp; Scrutiny Committee on 16 June 2016 with the changes recommended to Council on 29 June 2016.</p> <p>One of the revisions included the necessary reference to the 2014 Accounting Regulations.</p>	Actioned	Actioned

Ref.	Audit Finding	Management Response & Action	Responsible Officer	Date
13	<p><b>Data protection</b></p> <p>The Data Protection Act (1998) places a duty on the council to protect personal information that it holds and to provide individuals with access to the particular information that the council holds about them on request. It is, therefore, important that the council and its employees ensure the confidentiality, integrity, quality and availability of all the information it holds and takes steps to ensure that it does not break the law. Our review of the council's data protection arrangements noted that:</p> <ul style="list-style-type: none"> <li>• less than 10% of council officers have completed the online data protection course since it was introduced in July 2011</li> <li>• the council's register of data sharing agreements is recorded on an excel spreadsheet. At the time of our review, this spreadsheet was incomplete and out of date</li> <li>• no register of data processing agreements was found to exist although it is referred to in the council's Data Protection Policy.</li> </ul> <p><b>Risk:</b> the council's Data Protection arrangements are not robust enough to prevent a contravention of the Date Protection Act resulting in penalties for the council</p> <p><b>Recommendation:</b> the council's Data Protection arrangements should be reviewed to ensure that they are robust and operating as intended.</p>	<p>The findings were highlighted through an internal audit report on data protection and actions to address the issues are being coordinated through the information management governance board (IMGB).</p> <p>The Council has separately gone through a voluntary audit from the information commissioner and completed an action plan as a result of that audit, again managed through the IMGB.</p> <p>The Council's Fol and Data Protection Manager is reviewing the register of data sharing agreements. The IMGB agreed with internal audit that a register of data processing agreements is not required and the Data Protection Policy will be amended accordingly.</p>	FOI and Data Protection Manager	31/03/2017

